No. 6835

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE,
Petitioner,

vs.

JOHN FREULER, Administrator of the Estate of Louise P. V. Whitcomb, Deceased,
Respondent.

BRIEF FOR RESPONDENT.

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1. PRELIMINARY STATEMENT.

This is a proceeding to review a decision of the Board of Tax Appeals. It involved the income tax for the fractional last year, 1921, of the life of respondent's decedent. The petitioner had asserted a deficiency (R. 7). Of this amount respondent contested $675.77* (R. 17). The Board sustained respondent's position (R. 54).

2. THE FACTS.

A. C. Whitcomb died in 1889 (R. 34), leaving a will† devising the residue of his estate in trust to pay his widow, the decedent, one-third of the interest or income

*Petitioner's inconsistent statement is erroneous (*infra* pp. 31-32).

†Petitioner's statements that the trust was created by *deed* must be inadvertent (*infra*, p. 27).

for life, with remainder over (R. 34-35). The residue consisted largely of cash, bonds, stocks and notes (R. 35). In 1906 the San Francisco fire destroyed the improvements on certain real estate held by the trust (R. 35-36). The trustee then adopted a policy of building very substantial improvements on the San Francisco real estate, acquiring additional real estate and converting the other assets of the trust to accomplish this end (R. 36). There were minor improvements in 1906, major improvements in the years 1910 to 1913, including the Whitcomb Hotel, and further improvements thereafter (R. 70). These improvements and the hotel furniture depreciated (R. 36). During the taxable fractional year 1921 one-third of this depreciation was $7,167.19 (R. 19), the total for the entire year being $43,003.16 (R. 36). During that fractional year, however, the trustee paid the decedent her share of the income without making any deduction for depreciation (R. 38). When respondent made an income tax return for this fractional year in the name of decedent, he showed merely the decedent's share of the net income after deducting the depreciation (R. 42).

The trustee filed his account with the probate court having jurisdiction of the will (R. 38). The remaindermen objected because of the absence of a depreciation reserve (R. 38-39). The court sustained the objection (R. 39-40) and ordered restoration of such a reserve (R. 41). Respondent repaid $10,700 (R. 42), which is more than the one-third share of the depreciation for the fractional year in question (*supra*, p. 2). The excess was due to the fact that the statement of account covered many years. The balance of the amount due from decedent and respondent was represented by part of the notes of the beneficiaries, to whom the decedent's estate had been distributed.*

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3. THE LAW.

The applicable law is found in the Revenue Act of 1921. Section 219 of this act applies to "the income of * * * any kind of property held in trust" (subsection (a)) and specifically to "income which is to be distributed to the beneficiaries periodically, whether or not at regular intervals" (subdivision (4)). It requires the trustee to "include in the return a statement of the income of the estate or trust which, *pursuant to the instrument or order* governing the distribution, is *distributable* to each beneficiary, *whether or not distributed* before the close of the taxable year for which the return is made" (subsection (b)). It provides that on this income "the tax shall not be paid by the fiduciary, but there shall be included in computing the net income of each beneficiary that part of the income of the * * * trust for its taxable year which, *pursuant to the instrument or order* governing the distribution, is *distributable* to such beneficiary, *whether distributed or not*" (subsection (d)). The amount so taxable to the beneficiaries is allowed as a deduction on the trustee's income tax return (subsection (e)). Clearly enough, the only question that could be presented in this case is the determination of "that part of the income of the * * * trust for its taxable year which, *pursuant to the instrument* [the will of A. C. Whitcomb] *or order* [of the probate court] governing the distribution, is *distributable* to

*Petitioner's contrary statement is a mistake (*infra*, p. 30).

such beneficiary [the decedent] *whether distributed or not''* for the fractional year ending with decedent's death.

This is so clear that it may be superfluous to cite the following expressions of the Board:

> "Since the Act provides that there shall be included in computing the beneficiary's net income that part of the income of the trust, which, '*pursuant to the instrument or order governing the distribution,* is distributable to such beneficiary,' and since the provision of the will under which the petitioner became beneficiary provided for the payment to her of all the profits and income arising from the properties held in trust, in quarter-yearly installments, there can be no question but that the entire income and profits of the estate, undiminished in any manner whatsoever, should have been included in computing the petitioner's net income for 1921. Merely because the amount in question was not paid or distributed or, as the petitioner contends, was not 'distributable' because of the overpayment in 1920 does not render it any the less income within the meaning of section 219, *supra,* and, therefore, taxable as such."

Pyle v. Commissioner, 16 B. T. A. 218, 222-223.

> "The fact that the petitioners have reported in their returns the amounts distributed to them by the trustees is not conclusive as to the amounts upon which they are to be taxed, since the controlling sections of the statutes (section 219 (a) (4) and (d) of the Revenue Act of 1921 and corresponding provisions of the Revenue Act of 1924) provide that the amount to be returned is that which, 'pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, whether distributed or not.'"

White v. Commissioner, 25 B. T. A. 243, 249.

"A correct decision of the issues in this proceeding depends upon a proper construction of the provisions of the trust deed itself.

* * * * * * * * *

If the income was to be distributed currently by the fiduciary to the beneficiaries, then, under (b) (2) of section 219 of the Revenue Act of 1924, the fiduciary would be entitled to take as an additional deduction all of the income so to be distributed and there would be nothing left in the hands of the fiduciary to tax. And this would be true whether the income was actually distributed or not. * * * On the other hand, if the income for the taxable period now before us was not to be distributed currently to the beneficiaries, there is no additional deduction under (b) (2) of section 219 and the tax must be paid by the fiduciary."

McCrory v. Commissioner, 25 B. T. A. 994, 1007, 1008.

"The will of the decedent is the only evidence before the Board. From its terms we must determine whether the beneficiaries of the trust are entitled ratably to decrease their respective incomes by deducting therefrom certain amounts representing depreciation sustained by the depreciable assets included in the corpus of the trust. This identical question has heretofore been considered, exhaustively discussed, and decided by the Board. We have uniformly held that the terms of the trust instrument must determine whether trustees are authorized to set up a reserve for depreciation and to deduct ratable parts thereof each year from the income distributable to the beneficiaries."

Dixon v. Commissioner, 25 B. T. A. 1164, 1165.

> "The only question in these proceedings is to determine the amount of income of the trust which is taxable to the beneficiaries. Its solution depends upon the rights of these beneficiaries under the will of Charles Netcher."
>
> *Newbury v. Commissioner,* 26 B. T. A. 101, 106.

> "It is obvious that the intention of the testator and not the acts, judgment or interpretations of the trustees must determine this issue."
>
> *Boston Safe Deposit and Trust Company v. Commissioner,* 26 B. T. A. 486, 492.

> "We hold, therefore, that this trust was one in which the income was to be distributed periodically and, under the provisions of section 219 (a) (4) of the Revenue Act of 1918 and subdivision (d) of the same section of the Revenue Act of 1921 its income, whether distributed or not, was taxable to its beneficiaries."
>
> *Yukon Alaska Trust v. Commissioner,* 26 B. T. A. 635, 641-642.

We pass, therefore, to the question whether, as a matter of law, the depreciation was distributable under the will and the order of the superior court.

So far as the will is concerned, it is clear enough, on general authority, that the testator intended the decedent to get only her share of the "interest or income" and did not intend that the remainder interest should be depleted for her benefit. We have not here a specific bequest of a wasting asset. We have a general residuary devise. In fact, the assets covered by it "consisted largely of cash, bonds, stocks and notes" (R. 35, *supra*, p. 2). Such assets were not depreciable or wasting in their nature. The testator aptly spoke of the anticipated income from them as "interest" (R. 35). In subsequent years the nature of the corpus of the trust property has changed. Today it is almost entirely improved realty and hotel furniture. The improvements and furniture are highly depreciable, naturally a wasting asset. Under such circumstances, when a trustee acquires wasting assets, it is well settled that the life tenant is not entitled to the whole rental or other income, but that an adequate reserve must be set up in order to take care of the depreciation and protect the interest in remainder.

An early New York decision on this point is *Matter of Housman,* 4 Dem. 404. In that case there was a testamentary trust of a residuary estate. The court said:

> "The other exception of the executors relates to the refusal of the referee to sanction the transference from income to capital of a sum equal to the amount of depreciation in the value of certain furniture held by them as part of the residuary trust estate. This furniture was in use by Mrs. Housman at the time of her death at her residence, No. 46 west twenty-fifth street, in this city.
>
> *   *   *   *   *   *   *   *   *
>
> "I think that the evidence supports the claim, made by the executors in schedule B, of the account here in controversy, that they have obtained, by letting the furniture with the house, $2,500 more rent than they could have obtained by letting the house unfurnished. Meantime, the furniture has, of course, been greatly depreciating in value, and, according to the testimony of Mr. De Waltearrs, is worth to-day only about one half what it was worth at the time of the appraisement on the former accounting. * * * if, out of income that the executors have from time to time retained to cover its depreciation, the amount of that

depreciation were to be turned over to the *corpus* of the estate, the *cestuis que trustent* for life would be found to have received larger revenues than they would have obtained from the rents of the house unfurnished, together with the income that could have been derived from the proceeds of the furniture itself. * * * it seems but just that the depreciation should be made good out of the enhanced rental arising from the use of the furniture; otherwise the beneficiaries for life get all the advantage of the course pursued by the executors, and those in remainder suffer all the loss.

*   *   *   *   *   *   *   *   *

"I can conceive of no situation which would more clearly call for the application of the doctrine respecting the apportionment of the interests of life tenants and remaindermen * * *. The doctrine is this: That where a testator has limited a gift of general residue in successive estates, the first taker is not to have the annual proceeds of such property as may be held by the executors *in specie*, but such property must be treated as if converted and capitalized, so as to allow the first taker the annual income that would be yielded by such capital, and to preserve the capital itself to meet subsequent claims under the settlement.

*   *   *   *   *   *   *   *   *

"The decree to be entered upon this accounting will simply contain a provision for the continued retention of the portion of the income already withheld, and for the retention, besides, of such reasonable sum out of future income as will suffice to make good the probable loss by depreciation in the value of the furniture" (pp. 409-414).

This, of course, is but a special case on the general problem which the courts have to meet in adjusting the equities of life beneficiaries and remaindermen. The general principle has been stated:

> "*The existence of a corpus, principal, or fund is an essential element of the trust, and the preservation of this principal until the termination of the life estates is indispensable to the fullfilment of the testator's plans.* Therefore, *any depletion* of the principal tends to frustrate the fundamental purpose of the trust and should be avoided."
>
> *In re Gartenlaub*, 185 Cal. 648, 652.

This last case applied the principle in a very common situation, where a trustee has purchased bonds at a premium. The court, therefore, said:

> "Where the price paid for a bond consists of more than the par value thereof, that method of accounting should be adopted which will prevent the impairment of the principal unless the testator has clearly directed to the contrary. Otherwise the life tenant, who is entitled to receive only income, will, in effect, have received a part of the principal. In other words, where a premium is paid the ostensible interest yielded by the bond cannot be considered entirely as interest on the face value of the bond for a sum in excess of the face value has gone into the investment and the amount of interest remains unchanged, resulting, necessarily, in a decreased rate of return. A portion of the nominal interest is, therefore, a repayment of the premium" (p. 652).

The California law is in accord with the law of other jurisdictions.

> "The life tenant should neither be credited with an appreciation nor charged with a loss in the mere market value of the bond. But, apart from any speculative change in the market value, there is from lapse

of time an inherent and intrinsic change in the value of the security itself as it approaches maturity. It is this, and this only, with which the life tenant is to be charged. We therefore adhere to the rule, declared in the Baker case, that in the absence of a clear direction in the will to the contrary, where investments are made by the trustee, the principal must be maintained intact from loss by payment of premium on securities having only a definite term to run; while, if the bonds are received from the estate of the testator, then the rule in the McLouth case prevails, and the whole interest should be treated as income. These rules may not work perfect justice in all cases, and we fully appreciate that there may be inconsistencies between them; but it is far better that they should be uniformly adhered to, even at the expense of a particular case, than that the administration of estates should be subjected to constant litigation and disputes. It is also to be said that, unless the rule in the Baker case is to be observed, the relative rights of life tenant and remainderman would largely depend on the favor or caprice of the trustee, who might either buy a bond bearing a high rate of interest at a great premium and impair the principal, or buy a bond bearing a lower rate of interest substantially at par and preserve the principal intact."

In re Stevens, 187 N. Y. 471; 80 N. E. 358, 359-360.

"Assuming that the purchase of bonds even at a premium, was safe, prudent, and such as judicious men would make in the conduct of their affairs, which is substantially the rule heretofore laid down, the question arises: Inasmuch as it is certain that the *corpus* of the fund is to be diminished if this investment is permanent, whether the trustee may retain such sums annually as will restore to the fund at its maturity exactly what was taken therefrom at the time of the purchase? This is what the trustee has undertaken to do. If, as suggested in argument, there is any inaccuracy in the calculation by which this result is reached, this is a subordinate matter, to be determined by more accurate accounting should it be required, not necessary now to be discussed. That which is really income from a bond purchased at a price above par, say 120, and payable in 10 years, is not the amount received in interest annually, but that amount deducting therefrom the sum necessary to restore at the end of the 10 years the $20 premium. No prudent man would treat as income from his property the whole amount received when there was thus to be a diminution of his principal, amounting at the end of the 10 years to this premium, and steadily tending to this during the entire period. To deal with interest thus received as income purely, would, to the extent of the premium, exhaust the capital. The premium paid is no more than an advance from capital, which the remainder-man is entitled to have repaid if he is entitled to receive the capital intact. If, in such a case, the tenant for life should die before the maturity of the bond, and thus the whole advance not then be repaid, he would have paid no more than his just proportion. Unless the premium is to be restored, it is not easy to see how investments in bonds having a premium can be made in justice to the remainder-man, whose property (where a bond is kept to maturity) is diminished solely for the benefit of the tenant for life. Into the question how much income an investment, at a premium, in a bond, payable at a fixed future time, produces, the loss of the premium at that time necessarily enters as a factor.

* * * * * * * * *

"There can ordinarily be no better test of the income which a sum of money will produce, having regard to the rights of both the tenant for life and the remainder-man, than the interest which can be received from a bond which sells above par, and is payable at the termination of a fixed term, deducting from such interest as it becomes due such sums as will at maturity efface the premium. If such a bond has increased in value since its purchase, assuming it to have been an entirely safe investment, and none other should have been made, it has been because a change in the rates of interest, or some similar cause, has altered market values. There would be no reason to suppose that such a bond could be sold, and the amount received reinvested at any higher rate of interest, unless at the sacrifice of some safeguard in the investment. The investments of trust property should be made with a view to permanency, and not in any spirit of speculation; nor should changes be made except after much inquiry and circumspection, and ordinarily with an immediate and advantageous reinvestment in contemplation. In making such changes the trustees are not entitled so to exercise their authority as to vary or affect the relative rights of the *cestuis que trust*. Hill, Trusts, 483.

* * * * * * * * *

"The deduction from the full interest reserved to restore the premium at the end of the term was properly made."

New England Trust Company v. Eaton, 140 Mass. 532; 4 N. E. 69, 71-72, 74, 77.

"It is obvious that the amount advanced out of the capital of the fund for the payment of premiums should be made good, to prevent a loss when the securities mature. Payment of the whole annual income to the beneficiaries for life would produce this loss, and diminish the principal, to the injury of the remainderman. This method of dealing with the fund operates most equitably between the life tenant and the remainderman, in that they mutually share the advantages and losses."

In re Allis' Estate, 123 Wis. 223, 101 N. W. 365, 368.

See, also:

Furniss v. Cruikshank, 230 N. Y. 495, 130 N. E. 625;
New York Life Insurance & Trust Co. v. Baker, 165 N. Y. 484, 59 N. E. 257;
Gould v. Gould, 213 N. Y. S. 286;
Kemp v. Macready, 150 N. Y. S. 618;
Dexter v. Watson, 106 N. Y. S. 80;
Curtis v. Osborn, 79 Conn. 555, 65 Atl. 968;
Ballantine v. Young, 74 N. J. Eq. 572, 70 Atl. 668;
In re Wells' Estate, 156 Wis. 294, 144 N. W. 174.

Another common application of the principle is the amortization of leaseholds.

"Where moneys are received as the proceeds of what are termed wasting securities, such as leasehold estates which in progress of time will expire, or perish, or become of greatly diminished value, if the funds are held on a trust by which the income is to be paid for life to certain persons, and, on their decease, the remainder is given to other persons, it will be the duty of the trustees to add such dividends or moneys to the principal fund, so as to preserve it unimpaired for those entitled in remainder."

Healey v. Toppan, 45 N. H. 243, 266-267.

"In the ordinary case where the assets of the estate consist of so-called wasting securities the general rule is that executors or trustees should pay to the life tenant only so much of the income as represents a fair return upon the capital value, accumulating and retaining the residue for the benefit of the remaindermen. Frankel v. Farmers' Loan & Trust Co., 152 App. Div. 58, 136 N. Y. S. 703, affirmed 209 N. Y. 553, 103 N. E. 1124; Matter of Golding's Estate, 127 Misc. Rep. 821, 216 N. Y. S. 593. Only where it clearly appears from the will that the testator is not concerned as to whether or not there is anything left for the remainderman will the life beneficiary be entitled to receive the entire income of a 'wasting' security. Frankel v. Farmers' Loan & Trust Co., supra; Matter of Hall's Estate, 127 Misc. Rep. 238, 216 N. Y. S. 598; Matter of Schumann, N. Y. Law J. Dec. 14, 1926. In the cases just cited the life tenants were adjudged entitled to receive the whole of the net rents of the leaseholds involved because of the particular language of each will. In the Frankel and the Hall Cases there were provisions which permitted the invasion of the corpus of the estate for the benefit of the life beneficiary. In the Schumann Case the life tenant was entitled to the income of the principal until 1941, with power to invade the principal, at the end of which time the corpus of the trust vested absolutely in such beneficiary. *Here no such intention is manifest, nor is there in the will any other provision which takes this case out of the general rule governing 'wasting securities.'* On the contrary, the executors and trustees are charged with the duty, as shown by paragraph 'fifth,' 'to care for and preserve and invest' the residuary estate."

In re Hall's Estate, 224 N. Y. S. 376, 381.

See, also:

In re Murphy's Estate, 246 N. Y. S. 714;

In re Golding's Estate, 216 N. Y. S. 593.

A similar situation arose regarding royalties of a copyrighted book.

In re Elsner's Will, 206 N. Y. S. 765.

Somewhat similar also was a case concerning a limited toll bridge franchise.

Cairns v. Chaubert, 9 Paige's Chancery 160.

> "Where there is a *specific* gift for life of things which are consumed in the using, the tenant for life must have the possession and the use, according to the gift. But if the gift of such articles, or of perishable articles, is *residuary* or *general,* the trustee must sell the articles and invest the proceeds, so that the tenant for life may receive the interest or income, and the principal sum may remain for the remainder-man. If the property consists of leaseholds, annuities, or other interests, which grow less valuable by lapse of time, they must be sold, and the proceeds invested in some permanent form, so that the interest can be paid to the tenant for life, and the remainder-man can receive a proper sum as principal. If the trustee does not convert such property within a reasonable time, the remainder-man can proceed against him as for a breach of trust. The tenant for life will be compelled to refund whatever he has received beyond his equitable proportion, and the trustees, in the event of the failure or inability of the tenant for life to refund, must make good the difference."

Perry on Trusts and Trustees, 7th Ed., Vol. II, par. 548.

> "It has therefore been long established as a general rule, that where a testator makes a *general* gift of his estate, or the residue of his estate, generally to, or in trust for, a person for life with remainder over, so much of the property as consists of leaseholds, or

terminable annuities, or other interests of a perishable nature, must be converted and invested in permanent securities for the benefit of the remainderman. And the same rule applies to articles, which *ipso usu consumuntur,* such as wines, live stock, and other property of that nature. And if in contravention of this rule, the trustees suffer the tenant for life to receive the whole income arising from the perishable securities, he will be decreed to refund what he may have received over and above what he would have received, if the conversion had been duly made, and the proceeds invested in the three per cents.; and this difference will be treated as capital to be invested for the benefit of all parties entitled. The tenant for life is in the first place bound to make good this difference; * * *."

Hill on Trustees (Am. Ed.), 592-593.

"Bonds bought at a premium are ordinarily a wasting investment if the whole interest on the bonds is treated as income, because if the bonds are held until maturity the premium will be entirely lost, and even if they are not held until maturity, other things being equal, the premium will gradually grow smaller as maturity approaches. For this reason it is held by a majority of the jurisdictions that a trustee who has purchased bonds at a premium should deduct from the various collections of interest, and add to the principal, such sums as will replace the premium if the bonds are held until maturity. That is to say, he should establish a sort of sinking fund to repair the yearly waste of principal."

Perry on Trusts and Trustees, 7th Ed., Vol. II, par. 548a.

A distinction must be noted. Where a testamentary trustor has *specifically* devised or bequeathed a wasting asset it might well be implied that he contemplated that the life beneficiaries should have all the profits without deducting depreciation.

In re Chapman, 66 N. Y. S. 235, at 238.

But, where wasting assets were included in a general residuary estate, without specific description, or were acquired later by the trustee from funds derived by him through the conversion of capital assets of the trust estate, the implication of such an intent would be improper.

Petitioner makes no argument to the contrary and cites no authorities opposed to the foregoing. However, the record does contain the dissenting opinion of Mr. Murdock on the Board of Tax Appeals (R. 49-53). This contains the broad statement:

> "The will made no specific provision for depreciation, and the general rule in such cases is that the life beneficiaries take all income undiminished by depreciation" (R. 49-50).

Various authorities are listed (R. 50). None of these authorities supports this statement of the "general rule." Because they are cited by Mr. Murdock, however, we discuss them in detail.

The first authority cited is *In re Hoyt,* 160 N. Y. 607, 55 N. E. 282. That case was based upon the special provisions of the will and is not to be taken as establishing the general rule. If it ever operated to establish the general rule it has certainly been definitely overruled.

A result contrary to the *Hoyt* case was reached in *New York Life Insurance & Trust Co. v. Baker,* 165 N. Y. 484, 59 N. E. 257, (*supra,* p. 13). The *Hoyt* case was considered elaborately and was regarded as resting upon its special circumstances,

> "After a careful analysis of the facts outside of the will that the court deemed it wise to consider in ascertaining the intention of the testator, together with expressions therein *outside* of the fourth clause, by which the trust for the benefit of the daughter was created, * * *" (p. 258).

Again, in *In re Stevens,* 187 N. Y. 471, 80 N. E. 358 (*supra,* pp. 9-10), the *Hoyt* case was regarded as resting upon the peculiar circumstances that

> "a testator left as a trust fund for his daughter and only child a comparatively small share of a vast fortune and directed the income to be applied to her use 'in the most bounteous and liberal manner' " (p. 359).

In the *Stevens* case the court held that:

> "While we admit, in accordance with the decision in Matter of Hoyt, that the terms of the will may be such as to take a case without the general rule that the principal of the fund must be preserved intact, we think that to justify such an exception to the rule the intent should be expressed in the very clearest manner" (p. 359).

Of these decisions the appellate division has said:

> "The question as to when and under what circumstances trustees should set apart income to make good the shrinkage in capital value of securities purchased at a premium above par has been much discussed in this state, and cannot be said to have been put at rest until the decision of the Court of Appeals in Matter of Stevens, 187 N. Y. 471, 80 N. E. 358, 12 L. R. A. (N. S.) 814, 10 Ann. Cas. 511,

which was handed down in February, 1907. Prior to that time it had been held, in Matter of Hoyt, 160 N. Y. 607, 55 N. E. 282, 48 L. R. A. 126, that the question as to how the loss, occasioned by the payment of premiums on investing the principal of a testamentary trust fund, should be borne as between the life tenant and remainderman was to be determined by ascertaining, when that could be done, the intention of the testator as expressed in the will creating the trust, *in view of the relation of the parties and surrounding circumstances.* As was justly remarked by Chief Judge Cullen in Matter of Stevens, supra, no trustee could know how to safely act under such a rule."

Kemp v. Macready, 150 N. Y. S. 618, 619-620.

The court's surprise at this citation by Mr. Murdock of *In re Hoyt* will be increased when it notes that he had long been familiar with the *Baker, Stevens* and *Furniss* cases, and, indeed, had quoted with approval the statement in the latter case that

"the Court of Appeals, by a decision in *Matter of Stevens,* 187 N. Y. 471, 80 N. E. 358, finally established the rule that, *in the absence of a clear direction in the will to the contrary,* trustees must amortize from the income of said bonds a fund sufficient to make good the encroachment upon the trust fund as the result of premiums paid for bonds."

Quoted with italics by Mr. Murdock in *Simon v. Commissioner,* 10 B. T. A. 1186, 1188.

The second case relied upon by Mr. Murdock is *Devenney v. Devenney,* 74 Ohio St. 96, 77 N. E. 688 (R. 50). That case involved loss or gain through fluctuation in the market value of securities and had nothing to do with the question of depreciation of a naturally wasting asset.

The third case listed in the dissenting opinion, *Old Colony Trust Company v. Smith,* 266 Mass. 500, 165 N. E. 657 (R. 50), concerned the disposition of interest earned on funds of an estate during the period of administration. It had nothing to do with any question of depreciation.

The fourth case cited, *Blair v. Blair,* 82 Kan. 464, 108 Pac. 827 (R. 50), merely involved the question of the interpretation of a provision in the will allowing to the wife of the testator such income as she might "require." The court held that the word "require" meant what the wife reasonably might request from the trustee, rather than what the trustee determined to be her requirements. This is all that was decided in the case.

The fifth case cited is *Reed v. Longstreet,* 71 N. J. Eq. 37, 63 Atl. 500 (R. 50). The trustee there was *specifically* left a mortgaged farm and the question was whether or not the total income should be paid over to the life tenants or whether a reserve should be set up to pay off the mortgage so that the remaindermen would receive the property unencumbered. The court held that the life tenants, two daughters of the testator, were to receive the total income and that it would not be proper, under the facts presented, to set up a reserve. The court stressed the fact that the testator evidently desired to benefit his daughters, rather than their unborn children, who were the remaindermen, because the testator empowered the trustee to sell the mortgaged property and to hold the net proceeds of the sale upon the same trusts. The court said that such a sale would have produced the value of the equity of redemption and what was produced was to be held on the trusts, and that it could not have been the testator's intent that the income of the proceeds, when invested, should be accumulated until this income, when added to the principal, should equal the entire value of the farm.

The sixth case cited, *Dooley v. Penland,* 156 Tenn. 284, 300 S. W. 9 (R. 50), involved only the interpretation of a will, the question being whether the wife was entitled to the entire income, or only to so much as was necessary for her support. The court held that the language was broad enough to entitle her to the entire income. There was no question of whether or not a reserve should be set up, or as to what constituted income "within the terms of the will."

Finally Mr. Murdock cites *Gay v. Focke,* 291 Fed. 721 (R. 50), a decision of this court. That was an appeal from the Supreme Court of the Territory of Hawaii. The question was as to the amortization of certain leaseholds under a specific will there involved. The territorial court had held that as to one leasehold specifically bequeathed the will was to be construed as not requiring amortization. This is in entire accord with the authorities we have mentioned (*supra,* pp. 16-17). As to the other lease, which passed merely by a residuary bequest, the territorial court had held that it was subject to amortization. This is also in accord with the authorities we have cited (*supra,* pp. 7-17). Only the remaindermen appealed. In accordance with what we have said, this court affirmed the decision that the lease specifically bequeathed was not subject to amortization. It pointed out expressly that it was not passing upon the question whether the other lease was subject to amortization. It is clear, therefore, that there is nothing in this decision in any way inconsistent with the general law as laid down in the cases we have cited or with the California law as expressed in the *Gartenlaub* case (*supra,* p. 9). That Hunt, Ct. J., in rendering the opinion of this court, did not understand that he was expressing any doubt about the general law, is apparent from the authorities which he cited. Thus he approved *Kinmonth v. Brigham,* 5 Allen Mass. 270. In that case the court said:

> "where the property is of a wasting nature, as terminable annuities, leases, or the like, the value of the whole investment at the testator's death should be ascertained, and what should be regarded as income be computed upon that basis" (p. 279).

Hunt, Ct. J., also approved *Lawrence v. Littlefield,* 215 N. Y. 561, 109 N. E. 611. There was a residuary devise of unproductive real property in trust to sell, and the question was as to the effect of the executors' delay in making the sale. The case is in no way inconsistent with the other New York cases (*supra,* pp. 9-10, 13-15). It, in turn, approves *Gibson v. Bott,* 7 Vesey 89, a case which involved the amortization of a leasehold. Lord Eldon there ordered:

> "that it being for the interest of all parties that they should not be sold, a value shall be set upon them; and the persons entitled for life shall have interest at four per cent. upon that value from the death of the testator" (p. 97).

Finally Hunt, Ct. J., cited *In re Hollebone* (1919), 2 Ch. Div. 93. In that case a testator had been entitled to certain installments payable for the purchase of his interest in a partnership of which he had formerly been a member. The court held these installments had to be apportioned between the life tenant and remaindermen.

We submit, therefore, that in its decision upon this Hawaiian law, this court certainly did not intend in any way to depart from the general law as laid down in the authorities we have cited, but that by citing decisions from Massachusetts and New York, where the rule is laid down so clearly, as stated above, this court placed itself in line with those courts.

The foregoing review of the authorities cited by Mr. Murdock, in his dissenting opinion below (R. 49-50) shows that none of them sustained a construction of the Whitcomb will which would permit the distribution of the depreciation.

Most significant, however, is the fact that Mr. Murdock has subsequently expressed his unqualified approval of the views we have outlined above. In the later case he said:

> "Where a trustee makes investments with the corpus of an estate, he is duty bound to see that, so far as reasonably may be, the corpus always includes the equivalent of the amount invested. If bonds belong to a testator and are worth more than par at his death, the trustee may not have to retain any of the interest. But courts have frequently held, for example, that a trustee who buys bonds at a premium, should retain the equivalent of the premium from interest and pay only the excess to the life tenants. *In re Stevens et al.*, 187 N. Y. 471; 80 N. E. 358; *New England Trust Company v. Eaton*, 140 Mass. 532; 4 N. E. 69; *In re Allis Estate*, 123 Wis. 223; 101 N. W. 365; *Curtis v. Osborn*, 79 Conn. 555; 65 Atl. 968; *In re Gartenlaub's Estate* (Cal.), 198 Pac. 209; *Kate M. Simon*, 10 B. T. A. 1186; *Ballantine v. Young*, 74 N. J. E. 572; 70 Atl. 668; affirmed 76 N. J. E. 613; 75 Atl. 1100. Might he accomplish a

contrary result by simply erecting a building with corpus or borrowed funds and paying all of the rents to life tenants? He could if he had authority from the grantor expressed in the instrument creating the trust. Here the will gave no such authority.

"This case is distinguishable from those where the exhausting property was originally a part of the trust estate. The building in question was not in existence when the testator died, but was built at some later date. The principal part of the cost was paid from borrowed funds. The balance came from the corpus of the estate. The building was erected on land in Block 58 of the original town of Chicago. The will gave the trustee authority to thus borrow and build. There is nothing in the will indicating that the testator intended the trustee should not deduct depreciation on any buildings she might erect. In the only provision of the will specifically referring to this property, the testator indicated a wish that the real estate in this Block 58 should be held together for the benefit of his entire estate and the beneficiaries thereunder. Had the trustee made no provision for replacing the building or paying off the mortgage from the income of the building, obviously the testator's wish could have been carried into effect only at the expense of other property constituting corpus of the estate in violation of the rights of remaindermen. * * * We think that they had no right under the will to have the annual income from the building distributed to them except as it exceeded an appropriate amount to restore the cost of the building at the end of its estimated life."

Newbury v. Commissioner, 26 B. T. A. 101, 106-107.

Applying the above to the specific facts of the case at bar, the Whitcomb will must be construed as not permitting the distribution of this depreciation.

See, also, the opinion of Mr. Murdock in
Simon v. Commissioner, 10 B. T. A. 1186.

The general law, therefore, undoubtedly is that in the absence of something very definite in the will or the surrounding circumstances, under a residuary devise in trust, if the trustee purchases depreciable assets he must maintain a reserve for depreciation. These principles of general law were applied in the "order governing the distribution," the order of the probate court which required the retention by the trustee of an adequate depreciation reserve (R. 39-41).

We submit, therefore, that the applicable law fixed the tax with reference to that which was distributable to the decedent "pursuant to the instrument or order governing the distribution" (Revenue Act 1921, *supra,* pp. 3-6) and that neither under the instrument (the will of A. C. Whitcomb) nor the order (of the superior court) was this depreciation distributable to the decedent. And that is the whole case.

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4. PETITIONER'S BRIEF.

A. NONE OF THE POINTS IN PETITIONER'S BRIEF WILL SUPPORT A REVERSAL.

It is remarkable that the real point in this case is not made one of the four points which petitioner discusses. The real point, as we have seen, is the law regarding the construction of a general devise to a trustee for life tenant and remainder, so far as concerns the depreciation of wasting assets subsequently acquired. This point petitioner's brief entirely ignores. Petitioner's four points are:

"I. The distribution of the income to life beneficiaries, including respondent's decedent, was controlled in fact and in law by the terms of the deed of trust* executed in 1889.

II. The record discloses that there was no actual change in possession of all or a substantial portion of the income in question and no *bona fide* intention to restore the same to the trustee.

III. The question presented is one of general law arising under a Federal revenue statute as to which the Federal Courts are free to exercise their independent judgment.

IV. Even if it be conceded for the purpose of argument that local law should control, nevertheless the orders of the State court could not under the circumstances of this case retroactively change the taxable status of distributions already made" (Pet. Br. p. 1).

Making the correction, substituting the word "will" for "deed of trust," petitioner's first point is, indeed, the first branch of our argument as shown above. The distribution of the income to life beneficiaries, including respondent's decedent, was, we submit, controlled in fact and law by the will of A. C. Whitcomb, and by that will, construed in the light of the authorities we have reviewed above, it is clear that the depreciation was not distributable to the defendant.

Petitioner's second point seems to us utterly immaterial. The law, as we have said, taxes to the beneficiary "that part of the income which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, *whether distributed or not*" (*supra,*

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*By which petitioner must mean "will" (*infra*, p. 27).

pp. 3-6). "Actual change in possession of all or a substantial portion of the income in question" is not made a criterion of taxation under this law and the question of a particular individual's intention, whatever it may have been, is immaterial.

Petitioner's third point may well be granted. The authorities upon which we have relied in our construction of this will (*supra,* pp. 7-17) are not local authorities, but express the general law of the United States.

The same is to be said of petitioner's fourth point. It is not our position and has not been the position of the Board that the order of the state court "could * * * retroactively change the taxable status." The true point of the case is that under the law the depreciation was at no time distributable. The order simply recognized that and settled the trustee's accounts accordingly.

B. THERE ARE ERRORS OF FACT IN PETITIONER'S BRIEF.

In the opening statement of facts, petitioner recognizes that this is a testamentary trust (Pet. Br. p. 5). Subsequently, however, he regards the trust as one created by a deed *inter vivos* (Pet. Br. pp. 11, 12, 13, 16, 20, 31, 32).

Of this "deed of trust" petitioner says:

> "There was no provision for a depreciation reserve" (Pet. Br. p. 16),

ignoring the provision which the law implies from a devise of this kind and subsequent investments in wasting assets made under it (*supra,* pp. 7-17).

Petitioner repeats the statement that the distribution of the depreciation was made "pursuant to the terms of the instrument'' (Pet. Br. pp. 16-17, 20), thus seeming to assume that the instrument expressly required the distribution of the depreciation, and overlooking the true lawful construction of the will, which required the withholding of the depreciation (*supra,* pp. 7-17), a construction which the order of the state court confirmed (*supra,* p. 25).

Petitioner insists that:

> ''For nearly forty years the life beneficiaries under a deed of trust created in 1889 received and enjoyed the full income therefrom undiminished by any amounts on account of depreciation reserve'' (Pet. Br. pp. 11, 17, 20, 32).

For twenty-seven years from the time of A. C. Whitcomb's death in 1889 until 1906, when the fire resulted in a change in the investment policy of the trustee, no material part of the corpus of the trust estate was depreciable or a wasting asset of any other kind. The question of depreciation, therefore, did not arise. From 1906 until 1913 the trustee was engaged in various stages of the construction of the Whitcomb Hotel. Any attempt to base an argument, therefore, upon anything done by the parties to this trust in the treatment of depreciation prior to 1913 must fail. There was not and could not have been any question of depreciation before 1913.

Petitioner attacks the proceedings in the state court, characterizing them as a ''friendly settlement'' (Pet. Br. pp. 2, 11, 21, 32), ''a 'contest' in name only'' (Pet. Br. p. 21), laying emphasis upon ''the rapidity with which the proceeding moved'' (Pet. Br. pp. 15, 22), describing the notes finally given as ''peculiar'' (Pet. Br. pp. 22, 16). All this is a mere attempt to create an atmosphere. Either this proceeding was void for collusion or it was not. Petitioner does not dare to charge collusion and explicitly disclaims any such intention (Pet. Br. pp. 22, 32). The Board of Tax Appeals made no such finding, but did make findings about the regularity of the proceedings and the fact that all parties were represented at the hearing (R. 38-39). The furthest that the Board went was the mere suggestion in the opinion that "the proceeding before the Superior Court *may* have been a friendly one" (R. 45).

In his attempt to discredit the state court proceedings, petitioner lays stress upon "the fact that the objections were restricted to those years in which income taxes were a factor" (Pet. Br. p. 22), overlooking the fact that since there was no depreciation question prior to 1913 (*supra*, p. 28), there could have been no objection on that score.

In a further attempt to discredit the state court, petitioner says that that court "adopted in its orders the amounts claimed by the remaindermen to have been improperly distributed" (Pet. Br. p. 22). This is a manifest error. Paragraph 2 of the objections (R. 129-130) related to the matter of depreciation. Paragraph 3 of the objections (R. 131) related to losses in dealings with securities. The state court did allow the objections in paragraph 2 which related to depreciation (R. 136-139). It expressly disallowed the objections regarding losses in dealings in securities (R. 139). If a collusive decree had been possible, it could as well have covered both sets of objections as only one. The fact is, however, that both sets of objections were considered and submitted fairly to the court for such ruling as the court might make. The court allowed one set of objections and disallowed the other, because on the authorities (*supra*, pp. 7-17) there was nothing else to do about the former, and because the latter seemed at least doubtful.

Finally petitioner repeatedly ascribes to respondent the repayment of only $10,700 (Pet. Br. pp. 10, 16, 20, 23, 37), "scarcely more than nominal compliance" (Pet. Br. p. 11). He computes this amount as only 7% of the amount of depreciation distributed to respondent and the decedent, and says:

> "No notes or other obligations evidence even a simulated intention to repay the remaining 93 per cent" (Pet. Br. p. 23).

Nothing could be further from the fact. The truth is that all of the distributions of depreciation have been repaid. The Board fixed the total amount of depreciation at $622,434.11 (R. 39). The repayments were:

Appendix 8,	$305,867.06	(R. 145);
Appendix 9,	$118,353.85	(R. 146);
Appendix 10,	$ 69,159.35	(R. 147);
Appendix 11,	$118,353.85	(R. 148);
Respondent's payment	$ 10,700.00	(R. 42);
Total	$622,434.11	

Of the amount paid by respondent, which actually exceeded decedent's share of the depreciation for the fractional year in question (*supra*, p. 2), petitioner says repeatedly:

> "The record does not disclose on what account or with respect to what year or years this payment was made" (Pet. Br. pp. 16, 23, 37).

He makes two conflicting contentions about this, "Logically it would seem reasonable to apply it against the earlier years first" (Pet. Br. p. 23), and "for reducing the income of the year of payment rather than for making a retroactive change" (Pet. Br. p. 37). He overlooks the fact that the presumption as to the correctness of the Board's decision must require the assumption that the Board allocated this payment to the year here under attack, if, indeed, such an assumption were necessary to sustain the Board's decision. As we have said, the cash payment was more than sufficient to meet the whole amount of the depreciation for this fractional year (*supra,* p. 2).

We are at a loss in any attempt to ascertain what bearing petitioner claims these last matters can have upon the present appeal. Petitioner himself says:

> "We deem the matter of compliance or noncompliance with the orders of the probate court immaterial to a proper disposition of this appeal" (Pet. Br. p. 23).

Finally we find petitioner in error even as to the amount involved in this appeal. He states it definitely as $723.60 (Pet. Br. p. 1). His reference (R. 9) is to the statement annexed to the 60-day letter. This letter, indeed, did propose a deficiency of $723.60 (R. 7). While the original petition to the Board contested this whole amount (R. 5), an amended petition reduced the amount in controversy to $675.77 (R. 17). The Board actually fixed a deficiency of $95.61 (R. 54). This can only leave $627.99 now in controversy.

C. PETITIONER'S BRIEF IS BASED UPON VARIOUS OVERSIGHTS REGARDING THE APPLICABLE LAW.

It is by no means clear whether petitioner thinks this appeal is governed by the Revenue Act of 1921 (Pet. Br. pp. 2, 3, 11, 17-18) or by the 1924 and 1926 acts (Pet. Br. pp. 3-4, 11, 18-19). Surely only the 1921 act can affect this case, which is concerned with income for a fractional portion of that year. Perhaps the repeated references to the later laws in petitioner's brief are on the theory, which he expresses, that the latter are simply "clarifying provisions in new legislation * * * recognized as declaratory of existing law" (Pet. Br. p. 19). We fail to find anything in the acts of 1924 and 1926 which particularly clarifies the one issue in this case, that is, whether it is proper to tax respondent on account of the depreciation of the trust estate during the fractional year in question, which depreciation, "pursuant to the instrument (the will of A. C. Whitcomb) or order (of the Superior Court) governing the distribution" was *not* distributable to the decedent "whether distributed or not." If, however, any clarifying effect is to be given to any subsequent legislation, we respectfully call attention to subdivision (k) of Section 23 of the Revenue Act of 1928 relating to the depreciation deduction, which expressly provides:

> "In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of the instrument cre-

ating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each."

Under this law it is clear that even in the situation opposed to that of respondent here, where under a trust the amount distributable to the life beneficiary is the net income, plus the depreciation, so that the life beneficiary really gets periodical payments out of the corpus of the trust, to the detriment of the remaindermen, nevertheless such life tenant may deduct the amount of the depreciation so as to be taxable only upon the real income which he receives out of the net income of the trust estate. This amounts to a legislative repeal of the principles laid down in the earlier *Whitcomb* cases, *Appeal of Whitcomb,* 4 B. T. A. 80; *Appeal of Whitcomb,* 5 B. T. A. 191; *Whitcomb v. Blair,* 25 F. (2d) 528 (Pet. Br. pp. 14, 20), and the similar decisions upon which petitioner's whole argument is based (Pet. Br. p. 20, note 2). This legislation, therefore, naturally destroys the basis for petitioner's claim here. It has been suggested that it is only declaratory of the existing law. Hand, Ct. J., in *Merle-Smith v. Commissioner,* 42 F. (2d) 837, 842.

We cannot express too strongly, however, our conviction that this legislation was not necessary for our case and that our case is essentially distinguishable from all those upon which petitioner relies. This indeed petitioner impliedly concedes, if contrary to his contentions it should be held that the state law governs (see his point III, Pet. Br. p. 24), or that the decision of the Superior Court controls (see his point IV, Pet. Br. p. 32).

The essential distinction between the case now before this court and the various cases relied upon by petitioner is in the fact that, as pointed out above, in our case it is clear, and the state court has held, that the depreciation was not distributable to respondent's decedent. In all of the cases relied upon by petitioner the contrary was the fact, or was assumed to be the fact. For instance, in *Appeal of Whitcomb,* 4 B. T. A. 80, the determination proceeded on the ground that the total amount, net income plus depreciation, was the share of the net income of the trust to which she was entitled (p. 82). The Board indeed assumed that the depreciation deductions did not affect the computation of distributable income of the life beneficiaries (p. 84). *Appeal of Whitcomb,* 5 B. T. A. 191, was a similar case. The latter case was reviewed in *Whitcomb v. Blair,* 25 F. (2d) 528. Without considering the authorities, without any argument or discussion, the court simply assumed that the life tenants were entitled to receive the full income, without regard to exhaustion. These gratuitous assumptions alone distinguish these cases from the case at bar. The distinction is not one of federal law or of income tax law, but simply a matter of the correct construction of the will and the rights of the parties under it as a matter of general law.

Much of petitioner's brief is devoted to the question "whether the situation calls for the application of state or federal law" (Pet. Br. pp. 24-33). The materiality of this discussion is clouded somewhat by petitioner's positive assertion that "There is no necessity to consider the question" (Pet. Br. p. 20), and also by the astounding fact that *petitioner makes no effort whatever to establish either what the state or the federal law is on the point in question* (*supra,* p. 25).

Petitioner's discussion of this point is based chiefly upon *Swift v. Tyson,* 16 Pet. 1 (Pet. Br. pp. 24-26). This applies, of course, to questions of "general commercial law, where the state tribunals are called upon to perform the like functions as ourselves" (Pet. Br. pp. 25, 12, 24). Petitioner loses sight of the fact that we have not here a mere question of general commercial law. We are considering the application of a federal taxing statute truly enough, but the application of that statute to the rights and obligations of parties in a *testamentary* trust of *real property,* questions excluded from the application of the doctrine of *Swift v. Tyson* by the very cases upon which petitioner relies. Thus *Swift v. Tyson* itself excludes "rights and titles to things having a permanent locality, such as the rights and titles to real estate, and other matters immovable and intraterritorial" (Pet. Br. p. 25). See, also, the other cases he cites.

> "Since the ordinary administration of the law is carried on by the State courts, it necessarily happens that by the course of their decisions certain rules are established which become rules of property and action in the State, and have all the effect of law, and which it would be wrong to disturb. *This is especially true with regard to the law of real estate* * * *. Such established rules are always regarded by the Federal courts, no less than by the State courts themselves, as authoritative declarations of what the law is" (*Burgess v. Seligman,* 107 U. S. 20; Pet. Br. p. 28).

> "The courts of the United States adopt and follow the decisions of the highest court of a State * * * in reference to the common law of the State, and its laws and customs of a local character" (*Bucher v. Cheshire Railroad Co.,* 125 U. S. 555; Pet. Br. p. 29).

In applying federal revenue laws, and especially in applying federal income tax laws, the courts have been at pains to ascertain just what the local law was which created the property rights to which the federal law had to be applied. See, for instance, the painstaking analysis of state decisions in the various community property income tax cases.

> *Poe v. Seaborn,* 282 U. S. 101;
> *Goodell v. Koch,* 282 U. S. 118;
> *Hopkins v. Bacon,* 282 U. S. 122.

A similar attitude was adopted by the court in determining the effect of an oil lease under the state laws.

> *Group No. 1 Oil Corporation v. Bass,* 283 U. S. 279.

Petitioner draws a fine distinction regarding the application of the relative Section 219 of the Revenue Act of 1921. He speaks of "two types of distributions to beneficiaries, one of current income distributed under the terms of a self-executing deed of trust,* as in the present case, and the other where distribution is made by a guardian under court orders" (Pet. Br. p. 11). The matter is amplified (Pet. Br. pp. 17-19). Our best understanding of this demonstration is that petitioner means that since subdivision (4) of subsection (a) of Section 219, although it does not use the word "order," does speak of a guardian holding or distributing income as a court may direct, and does also speak of "income which is to be distributed to the beneficiaries periodically,"

> "From this it follows that the 'order' referred to in subsections (b), (d), and (e) is the order spoken of in subsection (a) (4)" (Pet. Br. p. 18).

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*will?

This despite the fact that there is no order spoken of in subsection (a) (4). From this basis petitioner argues that,

> "Since that 'order' relates exclusively to guardians, it follows that Congress intended the trust instrument to control in the case of trusts and the court order in the case of guardians" (Pet. Br. p. 18).

All this can have no other end than to exclude entirely from the consideration of this court the order of the state court which settled the trustee's account and determined that the depreciation was not distributable to respondent's decedent. We submit that no such strained construction can be given to the statute. Subdivision (4) of subsection (a) does not use the word "order." The only reason why subdivision (4) of subsection (a) groups the two kinds of income which it does is that, in contradistinction to the income mentioned in subdivisions (1), (2) and (3), the legal title to which in each case remains in the trustee until the end of the taxable year, the legal title of the income treated in subdivision (4) does not remain in the trustee. As soon as the *distributable* income becomes distributable, whether by virtue of a trust instrument or a court order, it is regarded for income tax purposes as passing to the petitioner. Since a guardian is a mere curator and at no time has legal title, *all* of the income received by a guardian vests immediately in the ward. For these reasons subsection (d) provides that the two classes of income discussed under subdivision (4) of subsection (a) are not taxable to the fiduciary, but to the beneficiary. Subsection (b) makes provision for returns accordingly. There is nothing in any of this which requires that the word "order," as used in these later subsections, or in any other portion of the act, be restricted to orders directed to guardians because of anything in subdivision (4) of subsection (a) which, as we have said, does not use the word "order."

Petitioner's brief is written in entire disregard of the peculiar provisions of the California statutes in regard to probate procedure and testamentary trusts. We realize that in many jurisdictions an executor appointed by a will proceeds to act under the will in that capacity. Such is by no means the law of California; the estate is subject to the control of the Superior Court for the purpose of administration (Probate Code, Section 300*); the executor named in the will has no power until he qualifies (Probate Code, Section 400); the Probate Court directs the issuance of letters to the executors named (Probate Code, Section 407). We realize, also, that in many, perhaps most, jurisdictions, the executor proceeds to make distribution when the estate is ready for it without any special court proceeding. That is certainly not the law of California; elaborate procedure is devised by which orders may be obtained for partial distribution, ratable distribution and final distribution (Probate Code, Sections 1000 to 1025); in the case of a testamentary trust, the executor delivers the property to the trustee under such a decree of distribution. There was such a decree in the instant case (R. 79-109). This decree, even if erroneous, was final (*Crew v. Pratt,* 119 Cal. 139, 147-152). It controls the rights of the parties under the trust. We realize, also, that in most jurisdictions a testamentary

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*The Probate Code is cited. Its provisions, however, are substantially those of the earlier laws which it codified.

trustee, like any other trustee, proceeds to act on his own responsibility; if he requires directions of any court on any point under the will, his application is to a court of equity. This is not the California system.

> "When a trust created by a will continues after distribution, the superior court shall not lose jurisdiction of the estate by final distribution, but shall retain jurisdiction" (Probate Code, Section 1120).

This section contains elaborate provisions for an accounting by the trustee, just as was done in the instant case (R. 110-128). We submit that such a trustee acts constantly under the direction of the court. Whatever he does is tentative until his accounts are settled. In California, therefore, we have an instance of "the juridical conception that a testamentary trusteeship * * * is due to the court authenticating the will * * * that offices conferred by wills are really due to the approval of administrative courts authenticating the will" (*In Re Ripley,* 167 N. Y. S. 162, 166). This, says Surrogate Fowler, "is wholly modern and is a part of the philosophical apparatus of the modern bureaucratic state. It is now generally recognized that all modern states tend to this form, and the courts tend to follow." He deplores this as in conflict with "fundamental traditions" but concedes there is evidence that it has gained ground. To such a trustee we find those provisions of the Revenue Act of 1921 peculiarly applicable where they speak of an "order governing the distribution of income" (subsection (b), subsection (d), subsection (e)).

It is clear that this is just the kind of case to which the draftsmen of the Revenue Act of 1921 intended these provisions to apply. It is even more clear that these draftsmen could not have intended these provisions to apply to any order relating to a guardian. Subdivision (4) of subsection (a), upon which petitioner relies in his attempt to apply the provisions of these later subsections to orders regarding guardians, relates to two subjects. The first is a trust under which income is distributed to beneficiaries periodically. The second is to a guardianship. As to the first of these subjects, the law taxes the income distributable (because, as we have said, it is that income which belongs to the beneficiaries). As to the second, the law taxes *all the income distributable or undistributable* (because it all belongs to the ward). It would have been idle in the later subsections to make any provision regarding the distributability of the income of a minor because, as we have said, subdivision (4) of subsection (a) taxes all of the minor's income, whether it is "to be *held or distributed.*" Therefore, petitioner's attempt to construe the provisions of these later subsections regarding distributability so as to confine or even relate them to the income of a minor held by his guardian is simply an attempt to give these later subsections an absurd construction. We submit that the matter of distributability is a criterion of the taxability of income only in cases like the instant case in which the trust requires the periodical distribution of income, and very definitely not in the case of income received by the guardian of a minor. The provisions of the latter subsections, therefore, applying this criterion, must refer, not to guardianships, but to cases of this kind and the words "instrument or order governing the distribution" in these sections must relate to an instrument such as the will of A. C. Whitcomb here, and the orders of the probate court shown in this record.

Two cases are mentioned by petitioner in his attack upon the order of the superior court settling the trustee's accounts in this case.

The first case cited is *Fidelity & Columbia Trust Co. v. Lucas,* 52 F. (2d) 298 (Pet. Br. pp. 32-35). In some respects, and from a general standpoint, this case illustrates a situation precisely the converse of that in the case at bar. The government was contending that under the Ewald will certain income was to be accumulated in the hands of the trustee and returned by him as income of the trust estate. The beneficiaries, however, contended that this income should have been distributed to them and returned as their income. On one point the decision is an important and strong one favoring our position. After stating the question the court expressly held that it would disregard what actually was done with the money.

> "Therefore, we may disregard the manner in which the trustee handled this yearly surplus income. The vital question is: How did L. P. Ewald by his will intend it to be handled? This intention must be gathered from the will itself" (p. 301).

That is, the case was decided by the district court there on the basis prescribed by Section 219 of the Revenue Act of 1921, the amount "which, pursuant to the instrument or order governing the distribution, is distributable to each beneficiary, *whether or not distributed,*" just as we contend the case should be decided here. On this basis, as we have said, there can be no question as to the correctness of our position (*supra,* pp. 3-6). Petitioner, of course, cites that case, not for the part of the decision mentioned above, nor, indeed, for the ultimate decision on the merits that the amounts in question were not distributable to the beneficiaries, but because, in reaching that conclusion, the district court disregarded a contrary construction of the will by the state circuit court. We are not familiar with the Kentucky practice and are not in a position to say whether or not the district court was right in this case in disregarding the state court's decision. All that can be said is that if the district court was right in that case, then the Kentucky practice is very different from the situation in California (*supra*, pp. 38-40). The same case was again before the district court (*Fidelity & Columbia Trust Company v. Lucas*, 1932 C. C. H., Vol. III, par. 9167). That decision emphasizes the correctness of the remarks we have made. On the phase of the case in which we maintain that the district court is taking a strong position in support of our contentions here, the district judge said the second time:

> "Certainly what the trustee did under the will is not binding upon this court."

The court's view of the proceedings in the state circuit court was further elaborated.

> "The petitions for advice and the orders of the court entered therein were dealing largely with administrative matters in the handling of the Ewald estate. There was no real issue made on the construction of the will in the State Court proceedings, and while the question may have been suggested by the record, the orders made by the state Court can not be accepted by this court as a deliberate judicial construction of the will."

In the case at bar the pleadings in the state court made a very definite issue on this question of construction (R. 129-135). The Board found that all parties were represented at the hearing (R. 39). The decision certainly passed definitely upon the contentions of the parties sustaining one objection and overruling another (R. 39-41). We submit, therefore, that the decisions under the Ewald will are in our favor and certainly not authority against our contentions here.

The other case relied upon by petitioner is *Ford v. Commissioner,* 51 F. (2d) 206 (Pet. Br. pp. 35-37). This is an outgrowth of litigation in which varying results were reached by the courts and the Board.

Ford v. Nauts, 25 F. (2d) 1015;
Appeal of Ford, 19 B. T. A. 1143;
Ford v. Commissioner, 51 F. (2d) 206.

In that case decedent left an estate of about $6,000,000, against which there seem to have been some debts. In December, 1920, six months after the death, the executors, without any authority from the Ohio court, actually made a distribution to the heirs of about $4,000,000 worth of securities. At that time the debts were still unpaid. The heirs received income on these securities and returned the income for taxation. In 1926 the probate court ordered that this distribution was void and directed the return of the securities distributed, with leave to make a redistribution "as of December 31, 1922." The beneficiaries, having paid their 1921 income tax upon this income, filed a refund claim and later brought suit to get it back. The district court (*Ford v. Nauts,* 25 F. (2d) 1015) held the original distribution unlawful under the Ohio law because of the existence of debts at that time. Accordingly, the district court held that the income received by the heirs individually really was income of the estate and, therefore, not properly taxable to the heirs individually.

The 1922 taxes were not paid by the heirs but were the subject of the proceeding before the Board (*Appeal of Ford,* 19 B. T. A. 1143). Additional facts were brought out. Apparently the $2,000,000 left in the estate after the distribution of 1920 was sufficient to pay the debts, because before the restoration order in 1926 the executors in 1925 filed in the probate court a statement showing that all debts had been paid. The Board of Tax Appeals relied largely upon the fact that the court's order really did not annul the distribution of 1920, but simply postponed it until 1922.

The Board's decision was reviewed in *Ford v. Commissioner,* 51 F. (2d) 206, which is the decision cited by petitioner (Pet. Br. pp. 36-37). The court pointed out that under the Ohio law the 1920 distribution "was premature," that by the 1926 order distribution was postponed until 1922. Regarding the status of the heirs, during the year 1922, the court held:

> "Certainly they then had complete legal title to the stock and to the dividends.
>
> *　　*　　*　　*　　*　　*　　*
>
> The stock distribution plainly was not void; the transfer of the legal title could not have been void; we interpret the probate court order only as one which found the transaction voidable, and so set it aside. * * * Even though then, in a sense, they lost legal title to the dividend fund, and even though this loss could be carried back by relation four years, still they always had the equitable title. If in 1922 the legal title was one they held in trust for the executors, yet this equitable title of the executors was in turn held in trust for the distributees. We cannot deduce from such a situation nonliability for the income tax" (p. 207).

The distinctions between the *Ford* case and the case at bar are obvious. In the *Ford* case, as the Circuit Court of Appeals pointed out so forcibly, the real ultimate ownership of the securities was undoubtedly in the heirs. True enough, the whole estate was subject to the claims of creditors. In fact, however, at the time of the distribution, the $4,000,000 of securities distributed were not needed to meet the claims of creditors. The creditors ultimately were paid out of the $2,000,000 retained by the executors in 1920. These heirs, therefore, having the ultimate ownership of the securities distributed in 1920, got possession of the securities and collected the income from them. The action of the executors by which the heirs got possession was premature, irregular. Nevertheless they, the ultimate owners, had possession and collected the income. The state court indeed never did actually annul the distribution of 1920, but only purported in 1926 to postpone its effect until 1922. Contrast that with the case at bar. The decedent received from the trustee $7167.19, one-third of the depreciation during the fractional year 1921. This was not money of which she had an ultimate ownership and which should have been withheld from her merely on account of the legal technicality. It was money in which she never had any right (*supra,* pp. 7-17) and in which the court ultimately held that she never had any right (*supra,* p. 25). It belonged equitably to the remaindermen and the trustee was bound to hold it with the rest of the corpus of the trust, not because of a legal technicality, but in order to protect the rights of the remaindermen.

Apart from these considerations, however, one thing alone makes the *Ford* decision utterly inapplicable. The

Ford decision is not based upon or governed by the subsections of section 219 of the Revenue Act of 1921, which we have discussed above (*supra,* pp. 3-6). These provisions could not have had any application to the *Ford* case. The *Ford* case did not involve any distribution of income by a fiduciary. The *Ford* case is based upon the actual receipt of the income directly by the heirs who then had the principal. Our case, however, is directly governed by the provisions of section 219. These provisions, as we have seen, make the basis of taxation in cases of this kind the amount "which, pursuant to the instrument or order governing the distribution, is distributable to each beneficiary, *whether or not distributed"* (subsection (b); subsection (d)). The test is not the amount *actually received by* the beneficiary, but the amount which, under the instrument or order governing the distribution, *he should have received.* Under these sections actual receipt of income becomes a false quantity. This is the fundamental difference between the *Ford* case and the case at bar.

In cases of this kind the binding force of decisions of the state courts has frequently been recognized.

> "It is very properly admitted by the Government that the New York decree is in this proceeding binding with respect to the meaning and effect of the will. The right to succeed to the property of the decedent depends upon and is regulated by state law (*Knowlton v. Moore,* 178 U. S. 41, 57), and it is obvious that a judicial construction of the will by a state court of competent jurisdiction determines not only legally but practically the extent and character of the interests taken by the legatees."
>
> *Uterhart v. United States,* 240 U. S. 598, 603.

> "We should lean toward an agreement with the state courts, especially in a matter like this."
>
> *Messenger v. Anderson,* 225 U. S. 436, 445.

(This opinion, of course, reverses that of the Circuit Court of Appeals, *Messenger v. Anderson,* 171 Fed. 785, upon which petitioner relies (Pet. Br. p. 31).)

> "This case concerns federal taxes collected from the Girard Trust Company, executor and trustee under the will of John J. Emery. They were paid under protest, and this is a suit against the government to recover them back. Such recovery was allowed in the court below, whereupon this writ of error was taken. The statutes involved are the Revenue Act of 1916 (39 Stat. 756), as amended by the Act of March 3, 1917 (39 Stat. 1000), and the Act of October 3, 1917 (40 Stat. 300), and the question involved is, as stated by the court below, 'whether the tax should be measured by the trust estate income in bulk or by the shares of that income divided among the beneficiaries separately.'
>
> "The facts are that John J. Emery, a resident of the state of Maine, died on September 5, 1908, leaving a will in which he directed that the funds involved here should accumulate. While his estate was in the course of administration, the gross income upon this fund was assessed with taxes for the years 1916, 1917, and 1918. Thereafter the question of validity of this accumulation trust was raised in the court of Maine having jurisdiction, with the result that by its decree, which was finally entered by consent, it was adjudged that 'the complainants were entitled to the residuary estate absolutely and in fee, free of any trust, as well as the income therefrom with accumulations thereon.' Referring to this decree, the court

below said, and we agree thereto, that 'this will sins against the policy of the law and the statutes enacted to enforce it is in effect admitted. That policy and these statutes nullify all provisions of wills which create perpetuities and limit accumulations to a prescribed period of time.' The effect of this decree was that, as to the fund here in question, which constituted the residuary part of the estate, the testator died intestate. Consequently the funds here in question did not pass as a trust, but as the residuary estate of the decedent, which belonged to his several heirs. *The differing conclusions of the government and of these taxpayers depend on the time at which the tax status is fixed.*

"The contention of the government is that, when these taxes were laid, the trust provisions of the will were then in force, and that *the government was entitled to levy its tax according to the then situation,* and consequently to tax the income as one accruing to the estate in gross as a trust. The contention of the taxpayer is that *the trusts were then void, although not so judicially determined,* and that the real situation was that the fund was really held by the trustee, who was also executor, as a residuary intestate estate, although that fact was not then, but subsequently, so decreed when the trust was adjudged void. We are of opinion that the *taxation acts as to estates were passed by Congress with appreciation of the fact that, as a practical administrative question, estates would often be in an undetermined situation incident to subsequent litigation as to rights thereto, and the taxation liability could not in such cases be fairly determined and justly laid until such disputed questions were determined. In the light of this practical consideration, we are of opinion the taxpayer's* *right and liability depended on facts, and not on appearances; that such facts, though subsequently determined by judicial decree, justly referred back, in this case,* for example, to the date of the testator's death, and the rights which then, as found by subsequent decree, really accrued.

"The court of Maine had the settlement of this estate in its grasp and sole jurisdiction. It was for it to determine whether the fund in question was an accumulating trust, held by the Girard Trust Company under a valid trust created by the will, or whether such trust was invalid, and that, consequently, as to this fund the testator died intestate, and that therefore it was in the hands of the Girard Trust Company as executor, and the real owners were the decedent's heirs under the intestate law. Such being the fact, it follows that the income of this fund was not the property of a trust estate accruing under a trust, but was the income payable individually to the several persons who inherited under the intestate laws.

"It therefore seems to us that this situation was one aptly described by the proviso of the statute here quoted: 'Income received by estates of deceased persons during the period of administration or settlement of the estate, shall be subject to the normal and additional tax and taxed to their estates, and also such income of estates or any kind of property held in trust: * * * Provided, that where the income *is to be distributed* annually or regularly between existing heirs or legatees, or beneficiaries the rate of tax and method of computing the same shall be based in each case upon the amount of the individual share to be distributed.' Comp. St. Sec. 6336b. *As the facts were ultimately adjudged, the income regularly accruing on this residuary estate was regularly payable to the owners of it, and was taxable as their incomes.*

"The judgment below, which held the tax should be assessed, not in gross, but upon the individual shares of the heirs, is affirmed."

McCaughn v. Girard Trust Co., 19 F. (2d) 218, 219.

"Because of the probate of the trust deed, and what has been said by the highest court of the state as to the validity of its clauses, the case is different than it was when here before (298 F. 894), and also from the case presented before the First circuit in 275 F. 513. We are not now at liberty to hold that the trust deed was invalid as a testamentary disposition."

Boal v. Metropolitan Museum of Art, 19 F. (2d) 454, 459.

"It cannot be contended for a moment that the Rhode Island court of probate and probate appeals lacked jurisdiction to determine what constitutes a will under the laws of that state. In fact it is the only court having such jurisdiction. Having determined that fact all other courts are bound by its decision relating thereto."

Atwood v. Rhode Island Hospital Trust Co., 34 F. (2d) 18, 22.

"The defendant and the federal courts are bound by the decisions of the appropriate state courts upon the probate of wills and their construction."

Hidden v. Durey, 34 F. (2d) 174, 178.

"Hence the case turns upon whether, after the Illinois decree, Marshall had a present interest in the income of Henry's share assignable under the law of Illinois.

* * * * * * * * *

"Under the trustees' contention Henry's share after his death was still subject to the provisions for accumulation, the restraints on alienation and the contingent remainders over. We need not consider the validity of these for we must accept the decree as holding that Henry's share was not so limited after his death."

Commissioner v. Field, 42 F. (2d) 820, 822.

"The effect of the above decision, as we construe it, is that the trust was not void, but only those provisions providing for the accumulation of income. *The fact that such decision was rendered after the taxable years in question does not, in the opinion of the respondent, affect the taxability of the trust during those years* on the income which under the provisions of the will was to be accumulated. We can not agree with his position.

* * * * * * * * *

"As finally determined in the instant case the trust was not one for the accumulation of income, or one in which the trustees were granted discretion as to the distribution, but the income was vested in the beneficiaries and they were entitled to receive the same from the date of the testator's death. *That right, although subsequently determined, fixed the status of the income for the taxable years in question.*

"Section 219 (a) (4) of the Revenue Act of 1918 provides that the tax imposed by sections 210 and 211 shall apply to the income of any kind of property held in trust, including income *which is to be distributed* to the beneficiaries periodically, whether or not at regular intervals, and subdivision (d) of the same section provides that in cases under paragraph (4) of subdivision (a) the tax shall not be paid by the fiduciary. In our opinion the income in question for the years 1918, 1919 and 1920, falls within the above provisions and is therefore not taxable to the petitioners.

*   *   *   *   *   *   *   *   *

"The situation in regard to the undistributed income for the year 1917 necessitates separate consideration due to the difference in the wording of section 2 (b) of the 1916 Act and section 219 of the 1918 Act. Section 2 (b) provides that the income of any kind of property held in trust shall be taxed to the trustee, except when the income is returned for the purpose of the tax by the beneficiary, '*Provided,* That where the income *is to be distributed* annually or regularly between existing heirs or legatees, or beneficiaries the rate of tax and method of computing the same shall be based in each case upon the amount of the individual share to be distributed.' Thus it will be seen that under the above section the only provision for the payment of the tax by the beneficiary is where the beneficiary has returned the income for the purpose of the tax. In all other cases the income is to be assessed to the executor, administrator, or trustee. The proviso does not designate another person against whom the tax is to be assessed, but provides that where the income is to be distributed annually or regularly between the beneficiaries the rate of tax and method of computation is to be based upon the amount of the individual share to be distributed, rather than upon the income of the trust in bulk. We are therefore of the opinion that for the year 1917 the petitioners are taxable upon all the income in question. See *McCaughn v. Girard Trust Co., supra;* and *Wooley v. Malley* (D. C.), 18 Fed. (2d) 668; 6 Am. Fed. Tax Rep. 6663."

Appeal of Appell, 10 B. T. A. 1225, 1231-32.

"In the cases which we are considering the amounts in question had not been paid to the beneficiaries, but were retained by the trustees with approval of the court having jurisdiction thereof and that in a state where the rule of law applicable to the situation here existing is in accord with the action taken by the trustees. Under such circumstances, we are unwilling to say that the course pursued by the trustees constituted an unauthorized withholding of income from the beneficiaries."

White v. Commissioner, 25 B. T. A. 243, 251.

In connection with his citation of the *Fidelity* and *Ford* cases, petitioner mentions *Burnet v. Sanford & Brooks Co.,* 282 U. S. 359, as supporting his suggestion that instead of taking the depreciation out of income distributable to the decedent in the fractional year 1921, the Board should have applied the total amount of depreciation returned by the decedent and respondent to "reducing the income of the year of payment" (Pet. Br. p. 37). The suggestion is clearly unsound. The respondent is not engaged in business and certainly cannot deduct this amount as a business expense. Moreover, it has been held, and very definitely:

"The trustees simply erred in distributing to the petitioner a greater amount in 1920 than she was rightfully entitled to under the provisions of the trust indenture, which for our purpose must be regarded as creating an obligation on the part of the petitioner to reimburse the estate, out of future 'distributable' income, the amount which had been erroneously credited or distributed to her. The error sought to be rectified occurred in 1920 and it is in that year, at least for income-tax purposes, that it must be corrected."

Pyle v. Commissioner, 16 B. T. A. 218, 223.

Perhaps the greatest significance to be found in petitioner's brief on the subject of this order of the state court here is that while endeavoring in every way to make out that the decision of the state court is not binding upon the tax authorities, nevertheless *petitioner at no time endeavors to establish that the decision of the probate court actually was wrong.* As we have shown, the decision was right and was in accord with the general law (*supra,* pp. 7-25).

This is emphasized by petitioner's repeated assertions that "the orders entered by the probate court in San Francisco *retroactively changed* the taxable status of income distributed during prior years" (Pet. Br. pp. 2, 12, 21, 32). From what we have said it must be clear that no such change, retroactive or otherwise, was involved in the order of the probate court. That order simply declared the law already existing (*supra,* p. 25).

Petitioner cites other cases as holding "that the decision of the state court cannot divest parties of rights which have previously accrued under a federal statute" (Pet. Br. pp. 33, 37). The four cases cited, *Burgess v. Seligman,* 107 U. S. 20; *Anderson v. Santa Anna,* 116 U. S. 356; *Great Southern Fire Proof Hotel Company v. Jones,* 193 U. S. 532; and *Kuhn v. Fairmont Coal Co.,* 215 U. S. 349, deal with no federal statute. They do not involve a situation like that here where the probate court proceeding, as it were *in rem,* "had the settlement of this estate in its grasp and sole jurisdiction" (*McCaughn v. Girard,* 19 F. (2d) 218; *supra,* pp. 47-50). For a careful consideration of the limits to which the doctrine of these cases cited by petitioner must be confined, it is only necessary to refer to the dissenting opinion of Mr. Justice Holmes in the *Kuhn* case.

In our specific situation, some of the cases we have already cited (*supra*, pp. 46-53) concerned state decisions rendered after the rights had accrued which were involved in the federal litigation. Nevertheless, the federal courts had difficulty in recognizing the binding effect of the state decisions. "Retroactivity" did not disturb them. We have in mind

Uterhart v. U. S., 240 U. S. 598 (*supra*, p. 46);

Messenger v. Anderson, 225 U. S. 436 (*supra*, p. 47);

McCaughn v. Girard, 19 F. (2d) 218 (*supra*, pp. 47-50);

Boal v. Metropolitan Museum of Art, 19 F. (2d) 454 (*supra*, p. 50);

Atwood v. Rhode Island Hospital Trust Co., 34 F. (2d) 18 (*supra*, p. 50);

Appeal of Appell, 10 B. T. A. 1225, 1231-1232 (*supra*, pp. 51-52).

This must dispose of the argument pressed by petitioner that a decision adverse to him in this particular case would be "paving the way for grave abuses" (Pet. Br. pp. 12, 38). No abuse whatever can be involved here. The decision of the probate court was in accordance with the will and the general law (*supra*, pp. 7-25). The statute imposes a tax upon the amount distributable pursuant to the will and the order, disregarding the amount actually distributed (*supra*, pp. 3-6). Upon any undistributable net income the trust estate is taxable (Revenue Act of

1921, section 219, subsection (e)). The result is that the total net income of the trust estate is bound to be taxable. Not a cent of net income can escape taxation; not a cent of net income actually has escaped taxation in the instant case. Petitioner, however, is seeking to tax, not the total net income of this family, but a greater sum. Because payments were made to the decedent in excess of her share of the net income of the trust, in excess of the amount distributable to her by her husband's will, in excess of the amount, the distribution of which the general law would permit, in excess of the amount ultimately determined by the order of the probate court, petitioner is seeking to levy a tax upon these payments, which could be nothing more or less than a capital transaction and not income at all. While not a grave and far reaching abuse, we submit that a rank injustice would be done by the enforcement of such a tax.

D. PETITIONER'S BRIEF DOES NOT COMPLY WITH RULE 24 OF THIS COURT.

We have been somewhat embarrassed in our presentation of the foregoing argument because of the failure of petitioner to comply with the requirements of Rule 24 of this court. It is not clear from his brief precisely what petitioner regards as the questions involved. He does not show the manner in which they are raised. There is no specification of errors. The petition for review (R. 55-59) does contain five assignments of error (R. 58). The brief does not refer to them and does not show that they are in any way connected with the argument in the brief. We do not find that these assignments raise any of the particular points discussed in the brief.

The first assignment is:

> "1. The Board erred in holding that the distributions made by the trustee to said Louise P. V. Whitcomb were not income to her in their entirety" (R. 58).

We find nothing in the record showing that there was any such holding. Nor could such a holding have been material to the case as the Board understood it. The question is not what was or was not income, but in this, as in every case, what was the amount to be included in the decedent's return in computing her taxable net income. The Board quoted the pertinent provisions of the act which, as we have said, includes the amount "which, pursuant to the instrument or order governing the distribution, is distributable to such beneficiary, whether distributed or not" (R. 43). The Board, therefore, undertook to determine, not the amount distributed, but the amount "distributable" (R. 44, 48).

The second assignment is:

> "2. The Board erred in holding that the distributions of the income of the trust received by said Louise P. V. Whitcomb without diminution on account of depreciation sustained by the trust property were not taxable income to her in their entirety" (R. 58).

Again, we know of no such holding. The Board merely found the facts and made the decision stated above.

> "3. The Board erred in holding that a payment made in a subsequent year and not shown to have re-

lated to an alleged excessive depreciation in the taxable year had the effect of keeping any portion of the distribution in the taxable year from being income to the taxpayer'' (R. 58).

Certainly the Board did not hold anything of this kind. It refused to consider any such question. What the Board said regarding the subsequent payments was:

> ''This, however, does not in our opinion change the situation. The amounts in question did not belong to the petitioners, and in our theory of the law cannot be income to them. Whether the petitioners ever repay such amounts to the trustee is a matter between them and the trustee and the other parties interested in the trust'' (R. 48).

We understand that petitioner concurs (Pet. Br. p. 23; *supra*, p. 31).

The fourth assignment is:

> ''The Board erred in holding that the decree of a Court passed in a subsequent year in a friendly suit to which the Government was not a party could affect the Government's right to income tax in the year in which the income was received'' (R. 58).

As to this, of course, it is apparent that the Board did not hold that this was a ''friendly suit'' (*supra*, pp. 28-29). Nor do we believe that the decision of the state court did ''affect the Government's right to income tax,'' because, as we see it, the decision of the state court was simply declaratory of the existing law. The ground of decision by the Board was its construction of the will (R. 48). It is true that in argument the decision of the state court is mentioned, followed by the remark:

> "Its decrees with respect to the trust are also binding on the several Federal Courts (*Uterhart v. United States,* 240 U. S. 598" (R. 44-45).

This decision of the supreme court of the United States seems to us amply to sustain the Board's remark. See also the other authorities cited (*supra,* pp. 46-53).

The fifth assignment is simply:

> "5. The Board erred in not approving the deficiency proposed for assessment by the Commissioner" (R. 58).

This is nothing more than a general statement that the Board's decision was wrong. It is not an assignment of any specific error.

None of the assignments is well taken. Petitioner noticed the assignments in the record and has not complied with the definite rules of this court. His attempt to write a brief urging mere general grounds not specifically assigned, must fail.

5. CONCLUSION.

The real question in this case is as to the effect of the will under the specific circumstances presented, with particular relation to the question whether the trustee should maintain a depreciation reserve. Another way of stating the same thing is to say that the question is whether the decree of the state court requiring the trustee to maintain such a reserve is right or wrong. Neither phase of this subject is discussed in petitioner's brief. There is much discussion of whether state or federal law is to be applied in giving effect to the will. There is no consideration whatsoever as to what either the state or the federal law on the subject is. There is much discussion as to whether or not the order of the state court is binding upon the parties here. There is no attempt whatever to show that that order was erroneous. On the other hand, we have shown definitely that the will can only be construed in the way in which it was effectuated by the state court and that the maintenance of a depreciation reserve was required. This ends the case, because the statute fixes the tax, not upon the amount actually distributed, but upon the amount distributable under the will and order (*supra*, pp. 3-6). No case has been cited holding or suggesting that under this statute the beneficiary is taxable upon amounts in excess of the amount distributable under the will and order merely because such excessive distributions may have actually been made for one reason or another. All of the cases upon which petitioner relies so confidently, including the earlier decisions of the Board and the court, under the Whitcomb will itself, were based upon circumstances existing or assumed that the amounts *distributable* actually were such that no depreciation reserve could be maintained.

It is respectfully submitted that in the case at bar, where the only amount distributable was the net income after setting aside a depreciation reserve, the Board was right in holding that the beneficiaries were taxable only upon the net income.

Dated, San Francisco, California,
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